

Where a title holding corporation exempt from Federal income tax under section 501(c)(2) of the Internal Revenue Code of 1954 retains part of its income each year to apply to indebtedness on property to which it holds title, such retention may be treated as if the parent received the income and used it to make a contribution to the capital of the corporation which applied such contribution to the indebtedness.

Where the parent organization is subject to the provisions of section 504 of the Code, income so retained by the title holding corporation will be treated as part of the parent's accumulated income.

Advice has been requested whether a corporation which is exempt from Federal income tax under section 501(c)(2) of the Internal Revenue Code of 1954 may retain part of its income each year to apply to indebtedness on property to which it holds title.

All of the corporation's stock is owned by an organization exempt from Federal income tax under section 501(c)(3) of the Code and to which section 504 of the Code is applicable. By agreement with the parent the corporation retains a part of income each year and applies it to the indebtedness it has incurred on the property to which it holds title.

Section 1.501(c)(2)-1(b) of the Income Tax Regulations provides that a corporation described in section 501(c)(2) of the Code cannot accumulate income and retain its exemption, but must turn over the entire amount of such income, less expenses, to an organization which is itself exempt from tax under section 501(a) of the Code. In view of this requirement, a question arises whether an organization exempt under section 501(c)(2) of the Code may make payments out of income to reduce the indebtedness on its property.

The title holding corporation is by its nature responsive to the needs and purposes of its exempt parent which established it mainly to facilitate the administration of properties. If it must remit all of its net income to the parent every year, it will have no funds with which to meet its own indebtedness. Rather, it will have to turn repeatedly to the parent for additional contributions to its capital or the parent will have to make direct payments on the indebtedness of the subsidiary. Thus, the subsidiary will be restricted in serving the needs of the parent in connection with the administration of properties.

It is the contention of the title holding corporation and its parent that the use of the income by the corporation to pay amounts necessary to retire indebtedness on the property should be treated as if the subsidiary had turned over the income to the parent and the latter had used such income to make a contribution

to the capital of the title holding corporation which in turn applied such contribution to the indebtedness.

It is held that, under the circumstances described, the title holding corporation may retain part of its income each year to apply to indebtedness on property to which it holds title. The transaction will be treated as if the income had been turned over to the parent and the latter had used such income to make a contribution to the capital of the title holding corporation which, in turn, applied such contribution to the indebtedness.

However, amounts of net income retained by the title holding corporation, under such circumstances, for application on the indebtedness will be treated as part of the accumulated income of the tax-exempt parent for purposes of section 504 of the Code. See Rev. Rul. 54-420, C.B. 1954-2, 128.